Energy: The Good, The Bad, and The Ugly

***e*Research Corporation** is pleased to provide an article courtesy of **Investing Daily**.

The article is reproduced below, beginning on the next page, or you can go directly to it at the following link: https://www.investingdaily.com/42603/the-oil-markets-make-a-big-move

You can also visit the **Investing Daily** website at the link below:
https://www.investingdaily.com/

Preferences | About Us | Contact Us | Privacy Policy

Investing Daily, a division of Capitol Information Group, Inc.
7600A Leesburg Pike
West Building, Suite 300
Falls Church, VA 22043-2004
U.S.A.

***e*Research** was established in 2000 as Canada's first equity issuer-sponsored research organization. As a primary source for professional investment research, our Subscribers (*subscription is free!!!*) benefit by having written research on a variety of small- and mid-cap, under-covered companies. We also provide unsponsored research reports on middle and larger-sized companies, using a combination of fundamental and technical analysis. We complement our corporate research coverage with a diversified selection of informative, insightful, and thought-provoking research publications from a wide variety of investment professionals. We provide our professional investment research and analysis directly to our extensive subscriber network of discerning investors, and electronically through our website: www.eresearch.ca.

Bob Weir, CFA: Director of Research

Energy: The Good, The Bad, and The Ugly

By Robert Rapier
July 3, 2018

Even though energy is my specialty, I had not intended to write about the topic again this week. However, recent events in the oil and gas sector are so significant that they compel me to once again focus on energy.

The stakes are enormous not just for energy, but for investors of all stripes. The fortunes of the energy patch and those of Wall Street are inextricably linked. In the U.S.A., the energy industry supports more than nine million jobs directly and indirectly, which is over 5% of the country's total employment.

According to recent statistics from Goldman Sachs, the energy sector accounts for roughly one-third of S&P 500 capital expenditures and roughly 25% of combined capex and research and development spending.

As I will explain, the latest news in this vast industry is a mixture of the good, the bad, and the ugly.

The EPA Declares War On Farmers

On the domestic front, the Environmental Protection Agency (EPA) released its proposed Renewable Volume Obligations for the U.S. biofuel mandate. The big news was that the EPA effectively reduced biofuel blending volumes by not reallocating volumes that had been waived due to hardship waivers granted by the agency.

The EPA also broke with precedent by refusing to allow comments on the decision not to reallocate. Scott Irwin, an agricultural economist at the University of Illinois, wrote on Twitter that this amounted to a declaration of war on corn/soybean farmers. Within the Trump administration, USDA Secretary Sonny Perdue also criticized the decision.

EPA Administrator Scott Pruitt has never been a fan of the Renewable Fuel Standard (RFS), and his agency will undoubtedly be sued over the decision. Further, Pruitt has numerous critics inside and outside the "Washington Beltway" that would like to see him removed. Replacing him with a different EPA administrator might result in an entirely different outcome for biofuel producers. Until then, score this one as a win for refiners.

But that was not the biggest news of the week.

OPEC Underwhelms Investors

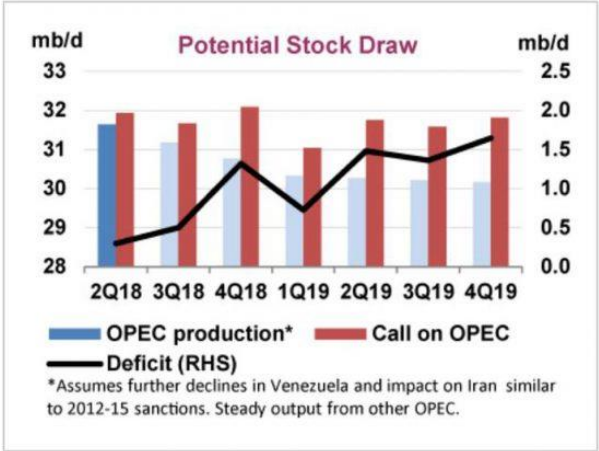
Oil prices rose last week to the highest levels since 2014. What was behind this price surge? Ironically, it was an announcement by OPEC that it would *increase* production.

Oil prices had weakened over the past month following a call from President Trump for OPEC to increase production in response to rising oil prices. After rising above $70 per barrel in May, the price of West Texas Intermediate (WTI) had dropped back to $65/barrel leading up to OPEC's June 22 meeting. It was widely anticipated that the group would decide to bump output at the meeting. At the meeting's conclusion, OPEC and its influential non-member partner Russia announced that the cartel would increase production for the first time since implementing production cuts in November 2016.

But WTI rallied by more than 4% following the announcement. Why? Because the market was underwhelmed by OPEC's decision. The bad news is that OPEC's move will not re-balance the market.

OPEC announced that it would restore about one million barrels per day (BPD) to the market, beginning this month. Iran had opposed the move, partially in protest to sanctions from the Trump administration. In reality, the output increase is not expected to exceed 700,000 barrels per day because some members are already pumping at maximum capacity.

Further, this output increase will not be enough to stabilize an oil market that still seeks equilibrium. The most recent Oil Market Report (OMR) from the International Energy Agency (IEA) projected the amount of oil that would be needed by OPEC through 2019 to balance the supply-and-demand equation:



By the end of this year, the call on OPEC is expected to be nearly 1.5 million BPD more than they were forecast to produce. Consequently, even if OPEC managed to follow through on the full output increase, it would be insufficient to prevent further declines in global crude oil inventories. Expectations that this production increase will not be enough to stabilize these inventory levels are the primary driver behind last week's oil price surge.

Also bear in mind that Saudi Aramco is still planning its initial public offering (IPO). Saudi Arabia would like oil prices to remain elevated, while appeasing President Trump. OPEC's action potentially satisfies Trump's request while ensuring that oil prices remain strong.

Oil prices surged again on news that the U.S.A. was pressuring its allies not to import oil from Iran, lest they risk sanctions. Iran currently exports 2.9 million BDP of crude oil and condensate to Asian and European markets. Even if there is modest compliance with this Trump administration request, it could accelerate the depletion of global crude oil inventories. That would likely drive oil prices even higher.

That would also make U.S. oil producers happy. Refiners, on the other hand, would likely suffer. Higher oil prices erode the margins of refiners, resulting in lower profits. So, even though refiners welcomed the good news on biofuel mandates, the spike in oil prices will probably have an ugly impact on earnings in the short term.

#####

Website: https://www.investingdaily.com/

See ABOUT THE AUTHOR on the following page.

ABOUT THE AUTHOR

It is hard to imagine anyone better suited to covering the energy-investment waterfront than Robert Rapier. Robert is no armchair analyst—he has two decades of in-the-trenches experience in a wide range of fossil fuel and biofuel technologies, including refining, natural gas production, gas-to-liquids, ethanol production and butanol production. During a six-year stretch at ConocoPhillips, Robert ran a team of engineers in Scotland working on oil and gas projects in the North Sea.

For two years, Robert was an efficiency expert in a Texas petrochemical plant. The process changes he implemented saved the facility $9 million a year. He later worked as the Engineering Director for a Dutch environmental-technology company and provided engineering support for a Chinese facility the company was constructing.

Robert was also a butanol engineer in Germany for the Celanese Corporation, where he designed a novel butanol unit that cut production costs by $5 million per year.

In all, Robert has spent more than a dozen years working on liquid fuels technologies. Along the way he has picked up five patents, including one for a breakthrough way to convert ethane into ethylene (U.S. Patent 7,074,977).

Now, in addition to guiding readers to timely energy plays in his twice-monthly *Energy Strategist*, Robert travels the world evaluating start-up energy companies for deep-pocketed investors. After grilling management and assessing the technology on-site, he makes a go/no-go investment decision. His wealthy private investors and hedge fund backers trust him to make the right choice for the same reason we do: his vast real-world experience in just about every facet of the energy industry. If Robert votes thumbs-up, millions of dollars flow into these cutting-edge outfits.

Robert earned his master of science in chemical engineering and a bachelor of science in chemistry and mathematics (double major) at Texas A&M University. He tells us he was "this close" to finishing his Ph.D. before he decided he was having a lot more fun making money in energy stocks.

A prolific writer, Robert's articles have appeared in *Forbes*, *The Wall Street Journal*, *The Washington Post* and the *Christian Science Monitor* — and he has been a featured expert on *60 Minutes* and *The History Channel*. His new book, *Power Plays: Energy Options in the Age of Peak Oil* (Apress, 2012), helps investors sort through doom and gloom, hype and misinformation to understand the true costs, benefits and trade-offs for each of our major energy options.

In what little spare time he has left, Robert consults for a number of energy projects, including biodiesel, ethanol, butanol, and biomass gasification facilities.